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No. 74-121

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In the

Supreme Court of the United States

OCTOBER TERM, 1974

CRAIG PHELPS, RECEIVER IN BANKRUPTCY IN THE MATTER OF CHICAGOLAND IDEEL CLEANERS, INC, BANKRUPT,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE PETITIONER

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BRIEF OF THE PETITIONER

OPINIONS BELOW

A Writ Of Certiorari issued to the United States Court of Appeals for the Seventh Circuit to review its judgment dated May 7, 1974. The opinion of the Court of Appeals was reported at 495 F.2d 1283 (7th Cir. 1974) and reported unofficially at 74-1 U.S.T.C. 84035.

The orders of the United States District Court for the Northern District of Illinois, Eastern Division, William J. Lynch, and the Referee in Bankruptcy (now Bankruptcy Judge), Charles B. McCormick, are not reported.

STATEMENT OF JURISDICTION

The cause presented for review is a proceeding in bankruptcy, prosecuted by the Receiver, and now Trustee, in bankruptcy. Jurisdiction is conferred upon this Court by 28 U.S.C. 1254(1) and the Bankruptcy Act, Section 24c, 11 U.S.C. 47c.

The judgment of the United States Court of Appeals for the Seventh Circuit was entered May 7, 1974, and mandate returned to the District Court on July 15, 1974. A petition for rehearing was filed on May 20, 1974, and denied by order dated May 24, 1974. The petition for a writ of certiorari was filed on August 14, 1974, and certiorari was granted on December 16, 1974.

STATUTES INVOLVED

The statutory provisions involved in this case are the Bankruptcy Act, 11 U.S.C. 1, et seq.: Sections 2a(21), 11 U.S.C. 11a(21); 64, 11 U.S.C. 104; 67c(3), 11 U.S.C. 107c; 70a(8), 11 U.S.C. 110a(8); and the Internal Revenue Code of 1954, Sections 6321, 26 U.S.C. 6321; 6322, 26 U.S.C. 6322; 6323, 26 U.S.C. 6323; 6331, 26 U.S.C. 6331; and 6672, 26 U.S.C. 6672, all of which are set forth in full in the Appendix hereto.

QUESTIONS PRESENTED FOR REVIEW

First: Whether the Court of Appeals incorrectly granted to the United States a priority based upon the Internal Revenue Code of 1954 for taxes in violation of and contrary to the priorities for payment of claims established by the Bankruptcy Act?

Second: Whether the Court of Appeals incorrectly held that service of a Notice of Levy upon an assignee

for the benefit of creditors subsequent to the assignment reduced the bankrupt's property then held by the assignee to the constructive possession of the United States?

Third: Whether the Court of Appeals incorrectly determined that the Bankruptcy Court lacked summary jurisdiction to adjudicate the controversy before it without the consent of the United States?

STATEMENT OF THE CASE

The bankrupt, Chicagoland Ideel Cleaners, Inc., is an Illinois corporation with its principal place of business in Chicago, Illinois. On June 28, 1971, the directors of the bankrupt corporation executed written consents (A. 8) to a general assignment (A. 5) of its assets for the benefit of creditors and on that date the bankrupt did assign and transfer all of its assets to Nathan Yorke, as assignee for the benefit of creditors. The assignee liquidated the assets of the bankrupt by sale and thereafter, on August 25, 1971, the Internal Revenue Service filed a Notice of Tax Lien (A. 10) with the Recorder of Deeds for the County of Cook, claiming a lien on the property or rights to property belonging to Chicagoland Ideel Cleaners, Inc., based upon assessments (A. 10) of March 12, May 5, May 28 and June 4, 1971, allegedly after demand, in the amount of $140,831.59. On the same date, the Internal Revenue Service effected a Notice of Levy (A. 10) upon Nathan Yorke, the assignee, without any further effort to reduce the proceeds to its possession.

An involuntary petition in bankruptcy was filed on September 14, 1971, against Chicagoland Ideel Cleaners, Inc., and Craig Phelps was appointed as Receiver on September 24, 1971. Chicagoland Ideel Cleaners, Inc., was adjudged a bankrupt on September 28, 1971.

On October 19, 1971, the Receiver filed an application (A. 9) requesting an order compelling the assignee to surrender and turn over to the Receiver the proceeds of his sale in his possession. By way of intervention, the United States answered (A. 10) the Receiver's application against the assignee by asserting that the Bankruptcy Court lacked jurisdiction over the United States and also lacked summary jurisdiction because the United States was entitled to possession of the monies held by the assignee. On December 9, 1971, the Referee in Bankruptcy ordered (A. 15) the assignee to turn over these proceeds to the Receiver. The United States filed a Petition for Review (A. 16) on December 16, 1971. The Referee's order was approved by the United States District Court for the Northern District of Illinois, Eastern Division, on January 11, 1972 (A. 19), whereupon the United States moved on January 21, 1972, to vacate the District Court's order. The motion to vacate was denied on March 2, 1972 (A. 20).

A Notice of Appeal (A. 20) to the United States Court of Appeals for the Seventh Circuit was filed on April 28, 1972, on behalf of the United States. The Court of Appeals (Pet. App. A) on May 7, 1974, reversed the January 11, 1972, order of the District Court (A. 19) approving the decision of the Referee in Bankruptcy. The Receiver filed a Petition for Rehearing which was denied on May 24, 1974. The Receiver filed a Petition with this Court for a Writ of Certiorari to review the judgment of the Court of Appeals on August 14, 1974, which was granted on December 16, 1974.

SUMMARY OF ARGUMENT

I.

The United States of America failed to record a Notice of Tax Lien as required by Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), prior to the sale of the taxpayer's property conducted by the assignee for the benefit of creditors. The purchasers at the sale obtained rights superior to an unrecorded federal tax lien, which is invalid as to them. Section 6323(a), *supra.* The federal tax lien failed and could not attach to the proceeds of the sale due to a termination of any property interest belonging to the taxpayer. *United States* v. *Bess,* 357 U.S. 51, 78 S. Ct. 1054, 2 L. Ed. 2d 1135 (1958). The proceeds passed into a trust estate created by the assignment and administered by the assignee as Trustee for the benefit of creditors as *cestuis que* trusts. *Levy* v. *Chicago National Bank,* 57 Ill. App. 143 (First Dist. 1894), *rev'd on other grounds*: 158 Ill. 88, 42 N.E. 128 and *Levy* v. *Metropolitan National Bank,* 158 Ill. 258, 42 N.E. 134. Consequently, no property or rights to property belonging to the taxpayer existed upon which the lien could attach. The opinion of the Court of Appeals for the Seventh Circuit erroneously granted lien rights to the United States and, in effect, created an additional and unwarranted first class priority to Section 64 of the Bankruptcy Act, 11 U.S.C. 104, based upon the Internal Revenue Code of 1954, in violation of and contrary to the priorities established by Congress in the Bankruptcy Act. The Bankruptcy Act is the foremost statement of federal policy concerning priorities in collective insolvency proceedings, *United States* v. *Randall,* 401 U.S. 513, 91 S. Ct. 991, 28 L. Ed. 2d 273 (1971), and is entitled to prevail over the provisions

of the Internal Revenue Code of 1954. *In Re United General Wood Products Corp.,* 483 F.2d 975 (9th Cir. 1973). The rights of the United States have been adequately protected by both statutory provisions without judicial amendment to the priorities of the Bankruptcy Act. The decision of *United States* v. *Eiland,* 223 F.2d 118 (4th Cir. 1955) relied upon by the United States should be distinguished and confined to its factual circumstances.

II.

The rights of the United States of America, even assuming, *arguendo,* that it did enjoy a federal tax lien, were postponed to the payment of expenses of administration and priority wage claims. Section 67c(3), 11 U.S.C. 107c(3), postpones to a third priority a tax lien on personal property not accompanied by possession. The policy of the Bankruptcy Act as expressed in Congressional amendments thereto, has been to subordinate tax claims and to favor expenses of administration and wage claims. H. Rept. 868 on H.R. 136, 89th Cong. 1st Sess. (1965). In accordance with this policy, the status of tax claims has been restricted through the adoption of a postponement provision in Section 67c(3), 11 U.S.C. 107c(3), which depends upon the existence of a possessory interest. Actual possession of the personalty is required in order to avoid postponement. *Goggin* v. *Division of Labor Law Enforcement of California,* 336 U.S. 118, 69 S. Ct. 469, 93 L. Ed. 543 (1949). A contrary result would constitute the utilization of legal fictions based upon the Internal Revenue Code of 1954 to override the system of priorities created in the Bankruptcy Act. *In Re United General Wood Products Corp., supra*; *United States* v. *Randall, supra.*

III.

The Bankruptcy Court enjoyed summary jurisdiction to adjudicate the controversy before it. The action originally was a dispute between the representative appointed by the Bankruptcy Court and an assignee for the benefit of creditors. Express provisions of the Bankruptcy Act grant summary jurisdiction to an action by the bankruptcy representative to require the assignee for the benefit of creditors to turn over the assets held by the latter in order to facilitate the expeditious and orderly administration of the bankruptcy estate. Sections 2a(21), 11 U.S.C. 11a(21); 70a(8), 11 U.S.C. 110a(8). The United States chose to intervene into the existing, summary proceedings and is bound by the nature of the proceedings. The United States cannot intervene into a proceeding for the purpose of objecting to the exercise of jurisdiction of the proceeding into which it is intervening.

ARGUMENT

I.

THE UNITED STATES FAILED TO RECORD ITS NOTICE OF LIEN PRIOR TO THE INTERVENTION OF THE RIGHTS OF THE ASSIGNEE'S PURCHASERS, AGAINST WHOM THE LIEN IS INVALID UNDER SECTION 6323(a) OF THE INTERNAL REVENUE CODE OF 1954, AND THE LIEN DID NOT ATTACH TO THE PROCEEDS HELD BY THE ASSIGNEE IN TRUST FOR THE BENEFIT OF CREDITORS.

The United States of America did not obtain a lien upon the property of Chicagoland Ideel Cleaners, Inc., the taxpayer and subsequently, the bankrupt, which entitled the United States to utilize the proceeds of the liquidation of the taxpayer's property to the exclusion of the rights of the Receiver in Bankruptcy. The lien claimed by the United States arises by virtue of statute, Section 6321 of the Internal Revenue Code of 1954, 26 U.S.C. 6321, and extends no further than the boundaries of that statute. The lien arises at the time of the administrative action of the Internal Revenue Service in making an assessment and demand for payment of the taxes,[1] Section 6322 of the Internal Revenue Code of 1954, 26 U.S.C. 6322, and is not valid against any purchaser, secured party, mechanic's lienor, or judgment lien creditor until the Notice of the Tax Lien has properly been filed or recorded. Section 6323(a) of the Internal Revenue Code

[1] Section 6322 provides that the lien arises "at the time of assessment", but Section 6321 makes demand a precondition to the creation of the lien which therefore arises as of the date of demand and non-payment but relates back to the date of assessment pursuant to Section 6322.

of 1954, 26 U.S.C. 6323(a). In the present case, the rights of purchasers from the assignee for the benefit of creditors during his liquidation of the taxpayer's assets intervened between the date of assessments, the last being made on June 4, 1971, and the date of the recordation, August 25, 1971, of the Notice of Tax Lien at the office of the Recorder of Deeds of Cook County, Illinois. By the terms of Section 6323(a), the lien of the United States lost its validity as of the assignee's sale and the purported levy thereafter served upon the assignee for the benefit of creditors was ineffective in attempting to reach the taxpayer's former property, which was no longer burdened by the lien of the United States. Thereafter, on September 14, 1971, the date of the bankruptcy, the proceeds of the sale held by the assignee passed into the constructive possession of the Bankruptcy Court free of the previous lien of the United States and provided the basis for that Court's summary jurisdiction. *Taubel-Scott-Kitzmiller Co.* v. *Fox,* 264 U.S. 426, 44 S. Ct. 396, 68 L. Ed. 770 (1924).

By its nature, the federal tax lien is a "secret lien", unknown to third parties who have no means of discovering the existence of the assessment until the Internal Revenue Service files its Notice of Tax Lien or asserts its rights under the lien. *United States* v. *Texas Eastern Transmission Corp.,* 254 F. Supp. 114, 117 (W.D., La. 1965); *United States* v. *Gilbert Associates, Inc.,* 345 U.S. 361, 73 S. Ct. 701, 97 L. Ed. 1071 (1953); *Marteney* v. *United States,* 245 F.2d 135 (10th Cir. 1957). This aspect of the lien's nature is attributable to the fact that it arises from an administrative action rather than as the result of judicial action. There exists no public record or other means available to third parties to learn of the lien's creation and, consequently, those persons whose

rights are junior to an unrecorded tax lien under Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), are in jeopardy of extending further credit to the taxpayer based upon the strength of its apparent assets which may already be subject to a prior federal tax lien.[2] In these situations, there is no method through which a general creditor can adequately protect himself. Such being the nature of the federal tax lien, the Petitioner, as representative of the general unsecured creditors, urges this Honorable Court to restrict the force and effect of the lien to its statutory limits.

When the sale of the taxpayer's property was conducted by the assignee pursuant to the authority of the assignment, the Internal Revenue Service had not recorded a Notice of Tax Lien. Pursuant to Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), the lien of the United States at this stage was not valid against the assignee's purchasers, who received unencumbered title.

The determination of whether a particular person qualifies as a purchaser is a matter of federal, rather than state law. *United States* v. *Hoper,* 242 F.2d 468, 470 (7th Cir. 1957). This Honorable Court had cause to consider the definition of a purchaser under the predecessor in the Internal Revenue Code of 1939, to Section 6323(a), which was Section 3672 in the case of *United States* v. *Scovil,* 348 U.S. 218, 75 S. Ct. 244, 99 L. Ed. 271 (1955). The *Scovil* Court determined that a purchaser for this purpose usually means one who acquires title for a valuable consideration in the manner of a vendor and vendee. Section 6323(a) itself has been interpreted to

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[2] *Federal Tax Liens,* Plumb, William T., Jr. (1972; 3rd Ed) American Law Institute

mean a purchaser in the ordinary sense. *Enoch* v. *Smith*, 359 F.2d 924, 926 (5th Cir. 1966). In its opinion, the Court of Appeals for the Seventh Circuit correctly stated that your Petitioner did not assert that the assignee was a purchaser, secured party, mechanic's lienor or judgment lien creditor. (Pet. App. A. 3a). See, *United States* v. *Texas Eastern Transmission Corp., supra,* at 254 F. Supp. 119. However, the Court failed to consider the rights of the purchasers from the assignee in what the Court described as his liquidation of the taxpayer's assets. (Pet. App. A. 2a). These persons would fall into the protected category of "purchasers".

The purchasers from the assignee, like all other parties, were unaware of the secret lien which had arisen but had not been asserted or recorded as a matter of public record. While it is true that such purchasers would be aware of the financially troubled condition in Chicagoland Ideel Cleaners, Inc., due to the nature of an assignee's sale, such knowledge does not prevent one from qualifying as a purchaser within the meaning of Section 6323(a). *Marteney* v. *United States, supra,* at 245 F.2d 139; *United States* v. *Von Cseh,* 354 F. Supp. 315 (S.D. Tex. 1972); *United States* v. *Meyer,* 199 F. Supp. 508 (S.D. Ill. 1961). Mere knowledge of financial difficulties does not impute to a prospective purchaser knowledge of the existence of unrecorded tax liens. If the prospective purchaser could not qualify as a Section 6323(a) purchaser due to knowledge of his vendor's financial or possible financial difficulties, then few could so qualify under similar conditions and Section 6323(a) would never apply. Accordingly, the requirement that the Internal Revenue Service record its Notice of Lien to put prospective purchasers on notice of its rights and in doing so, terminate the possibility of said prospective purchasers

of qualifying as Section 6323(a) purchasers would be so weakened as to effectively vitiate the only protection granted to this class. The consequences of such a holding will be to produce increasing numbers of premature bankruptcies due to the inability of troubled businesses to partially liquidate assets in order to gain needed liquidity to continue operations and seek financial rehabilitation.

The Petitioner urges this Court to hold that the purchasers from the assignee were Section 6323(a) purchasers. In so holding, the Court would be amply supported by the purpose of the section and its predecessor in the 1939 Code of protecting purchasers from the Internal Revenue Service's secret lien and giving the purchasers superior rights over an unrecorded tax lien. *United States* v. *Gilbert Associates, Inc., supra*; *Enoch* v. *Smith, supra.* Congress has determined by virtue of its enactment of this section that the rights of a purchaser should be inferior to the federal tax lien only when Notice of Lien has been recorded as a matter of public record prior to the creation of the rights of a purchaser. To hold otherwise, this Court would be seriously weakening the only protection against this secret lien by holding that some indefinite knowledge or suspicion on the part of the purchasers give them cause to believe that an administrative assessment may have been made. The effect of such a decision would be to grant to the Internal Revenue Service a lien superior to the rights of a purchaser for value. In addition, this Court's definition of a purchaser in *Scovil* utilized a vendor-vendee test, in which knowledge of possible federal tax liens would not be present.

In summary, the Petitioner believes that the assignee's purchasers took title to the property of Chicagoland

Ideel Cleaners, Inc., free of the Internal Revenue Service's lien, which was not valid against them due to the failure of the Internal Revenue Service to seasonably record a Notice of Lien before the sale.

Section 6323(a) provides that a federal tax lien is not valid against purchasers, such as are present in the case at bar. The controversy in this case has revolved around the proceeds in the possession of the assignee derived from his sale. The Petitioner believes that an examination of relevant decisional authorities will reveal that the federal tax lien does not attach to the proceeds of the assignee's sale.

As hereinbefore stated, the Internal Revenue Service did not record notice of their secret lien prior to the assignee's sale and therefore suffered the resulting invalidity of its lien. The lien did not attach to the proceeds of the taxpayer's property sold by the assignee for the reason that a lien does not survive a transformation in character of the property with resultant termination of the property interest of the taxpayer. Section 6321 of the Internal Revenue Code of 1954, 26 U.S.C. 6321, provides that a lien arises in favor of the United States upon all "property and rights to property" of the taxpayer. Due to the assignment and sale by the assignee, the proceeds did not constitute the taxpayer's property or right to property.

The determination of the nature and extent of property and rights to property belonging to the taxpayer is a question of state law. *United States* v. *Bess, supra*; *Aquilino* v. *United States,* 363 U.S. 509, 80 S. Ct. 1277, 4 L. Ed. 2d 1365 (1960); *United States* v. *Durham Lumber Co.,* 363 U.S. 522, 80 S. Ct. 1282, 4 L. Ed. 1371 (1960); *City of New York* v. *United States,* 283 F.2d 829 (1960).

It was stated by this Honorable Court in *United States* v. *Bess, supra,* that Section 6323(a)'s predecessor, Section 3672 of the Internal Revenue Code of 1939, creates no property rights but merely attaches consequences, federally defined, to rights created under state law. Therefore, resort must be made to the law of the State of Illinois concerning the property interests, if any, of the taxpayer following the assignment.

In Illinois, a general assignment for the benefit of creditors establishes a trust estate consisting of the assignor's property which is administered by the assignee as Trustee for the benefit of creditors who occupy the position of *cestuis que* trust. *Levy* v. *Chicago National Bank,* 57 Ill. App. 143 (First Dist. 1894), *rev'd. on other grounds*: 158 Ill. 88, 42 N.E. 128, and *Levy* v. *Metropolitan National Bank,* 158 Ill. 258, 42 N.E. 134. The trust so created is an express trust which is capable of supporting an action to enforce its terms by a creditor invoking chancery jurisdiction over trusts. *Howell* v. *Moores,* 127 Ill. 67, 19 N.E. 863 (1889). Upon the assignment, the assignee receives legal and equitable title to all of the assignor's property, whether real or personal, which he holds and administers as Trustee. *Reynolds* v. *Burns,* 20 Ill. 2d 179, 170 N.E. 2d 122 (1961). The transfer of title to the assignee is absolute and there exists no right of reverter or equity of redemption in the assignor. *Weber* v. *Mick,* 131 Ill. 520 (1890); *Browne-Chapin Lumber Co.* v. *Union National Bank of Chicago,* 159 Ill. 458, 42 N.E. 967 (1896). Once made, the assignor is powerless to defeat or weaken the assignment and cannot recover the property or any interest therein. *Taylor* v. *Seiter,* 100 Ill. App. 643 (Fourth Dist. 1901), *affirmed* 199 Ill. 555, 65 N.E. 433. Upon the sale by the assignee as Trustee for the benefit of creditors, the federal tax lien lost its validity and the proceeds passed

into the estate in which the assignor, Chicagoland Ideel Cleaners, Inc. had no right, title or interest. These proceeds could not have been brought into the possession or enjoyment of the assignor and were being held for the benefit of another. Hence, the property interest of Chicagoland Ideel Cleaners, Inc. was extinguished and the federal tax lien upon which the United States relies failed for want of any property to which it could attach. *United States* v. *Bess, supra.*

In *United States* v. *Bess, supra,* the transformation of the assets was similar in substance to the case at bar. *Bess* involved the attempt by the United States to assert against the beneficiary a federal tax lien upon the full proceeds of a life insurance policy for past due income taxes of the decedent. In rejecting the government's position, this Honorable Court stated through Mr. Justice Brennan:

> "It would be anomalous to view as 'property' subject to lien proceeds never within the insured's reach to enjoy, and which are reducible to possession by another only upon the insured's death when his right to change the beneficiary comes to an end. We therefore do not believe that Mr. Bess had 'property' or 'rights to property' in the proceeds, within the meaning of Section 3670, to which the federal tax lien might attach. Cannon v. Nicholas, 10 Cir., 80 F. 2d 934; See United States v. Burgo, 3 Cir., 175 F. 2d 196." (357 U.S. at 55-56).

It is the contention of the Petitioner that just as surely as Mr. Bess lost all property interest in the proceeds[3]

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[3] Applying an analysis of the economic realities, the Court found that the cash surrender value of the policy constituted a fund of paid premiums held for the benefit of the *insured* and was a sufficient property interest upon which the lien could attach.

of the policy of insurance when he passed out of this life, so did Chicagoland Ideel Cleaners, Inc. lose all interest in its assets upon the assignment and sale by the assignee. As assignor, it had irrevocably parted with all interest in and to its assets and had no possibility of recovering the proceeds of the sale. The fund thusly created was held for the benefit of its creditors, and not for the assignor, leaving no property or rights to property belonging to the taxpayer upon which the lien could attach. The subsequent recordation of Notice of Tax Lien and service of Notice of Levy had no effect and did not operate to increase the rights of the Internal Revenue Service. The Notice of Lien only operates to terrminate the rights of purchasers, secured parties, mechanic's lienors and judgment lien creditors who are subject to the lien and obtain their rights after the recordation of the notice. In the same manner, Section 6331 of the Internal Revenue Code of 1954, 26 U.S.C. 6331, provides for a procedure to collect the tax by levying upon taxpayer's property subject to the federal tax lien. The proceeds of the assignee's sale did not constitute the taxpayer's property nor were they subject to the federal tax lien. Thereafter, the petition initiating the bankruptcy proceeding removed the proceeds into the custody of the Bankruptcy Court, providing for that Court's exercise of summary jurisdiction. *Taubel-Scott-Kitzmiller Co.* v. *Fox, supra.*

Confusion concerning the nature of Section 6323(a) has been caused by the decision entitled *United States* v. *Eiland,* 223 F.2d 118 (4th Cir. 1955). The *Eiland* opinion based its holding upon the fact that the indebtedness due the taxpayer which the Internal Revenue Service levied upon constituted intangible personal property and interpreted Section 3672 of the Internal Revenue Code

of 1939, which is substantially similar to the present Section 6323, as applying only to tangible personal property. The Court reasoned that the requirement of filing notice of the federal tax lien as a matter of public record for intangible property could not give any advantage to the general creditors of the taxpayer, hence, its application to an indebtedness would be unreasonable. The Petitioner respectfully suggests that the holding of *Eiland* is erroneous and contrary to the purpose of Section 6323(a), requiring the decision to be overruled or carefully distinguished and restricted to its factual circumstances in order to preserve the protection granted by Congress to general creditors by this provision.

Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), like its predecessor, Section 3672, was intended to give public warning of the secret federal tax lien, so further credit would not be advanced to a taxpayer whose assets were subject to the lien of the United States. *United States* v. *Gilbert Associates, Inc., supra*; *Enoch* v. *Smith, supra.* Tangibles are subject to physical seizure as well as by notice filing, either of which action can constitute the perfection of a lien interest therein. Conversely, intangibles cannot be physically seized in the same sense and for the purpose of perfecting an interest, notice filing is often the only possible method. Consequently, the requirement contained within Section 6323(a) that a federal tax lien be filed as a matter of public record is all the more crucial when dealing with intangibles for it will be the only notice available to interested parties. The rule applied in *Eiland* defeats the purpose of the section and should be corrected by this Court. In excusing the Internal Revenue Service's failure to comply with the notice requirement of Section

3672 by construing service of a Notice of Levy to transfer the debt to the United States, the Fourth Circuit created a rule perhaps technically correct in *Eiland,* but which is clearly erroneous in the instant case. Under the Internal Revenue Code of 1954, the Internal Revenue Service could levy upon the taxpayer's property based on a Section 6321 lien without filing a Notice of Tax Lien, if the rights of persons protected by Section 6323(a) did not intervene between the date of assessment and levy. Section 6331(a), 26 U.S.C. 6331(a). In the case before this Court, the property no longer belonged to the taxpayer when the Notice of Levy was served and the rights of purchasers had intervened. Therefore, the application of *Eiland* to the different factual situations presented in this case should not be condoned by this Court.

This Honorable Court has stated in *United States* v. *Randall, supra,* that the Bankruptcy Act is an overriding statement of federal policy on the question of priorities and rejected the attempt of the United States to improperly utilize the provisions of the Internal Revenue Code in order to create an unwarranted priority. If the United States is allowed to succeed in this instance where it failed in *Randall,* then the erroneous opinion of the Court of Appeals in upholding the federal tax lien will disturb the careful balance established by Congress between the respective interests of the expenses of administration and wage claims, and taxes due to the United States. For this reason, the Court of Appeals for the Ninth Circuit rejected a similar argument advanced by the United States and accepted by the Court of Appeals for the Seventh Circuit. *In Re United General Wood Products Corp., supra.* The Petitioner urges the Court to preserve the vitality of the Bankruptcy Act inviolate from encroachment by the Internal Revenue Code.

Nicholas v. *United States*, 384 U.S. 678, 86 S. Ct. 1674, 16 L. Ed. 2d 853 (1966); *Guarantee Title and Trust Co.* v. *Title Guaranty & Surety Co.*, 224 U.S. 152, 32 S. Ct. 457, 56 L. Ed. 706 (1912); *Davis* v. *Pringle*, 268 U.S. 315, 45 S. Ct. 549, 69 L. Ed. 974 (1925).

II.

THE SERVICE BY THE UNITED STATES OF A NOTICE OF LEVY UPON THE ASSIGNEE DID NOT REDUCE THE PROCEEDS TO THE ACTUAL POSSESSION OF THE UNITED STATES AND ITS LIEN WAS POSTPONED TO THE FIRST AND SECOND PRIORITIES OF SECTION 64 OF THE BANKRUPTCY ACT.

The Petitioner contends that the United States gained no lien upon the proceeds of the assignee's sale and that the proceeds passed into the possession of the Bankruptcy Court as of the date of bankruptcy. Accordingly, the United States would be entitled to a fourth priority among unsecured creditors of the Bankruptcy Act, Section 64, 11 U.S.C. 104. The United States has taken the position that it did have a perfected lien upon the taxpayer's property accompanied by constructive possession due to service of its Notice of Levy upon the assignee. The Petitioner contested and continues to contest the existence and validity of the federal tax lien, but recognizes his obligation to respond to the additional position of the United States with reference to the question of the effect of service of the Notice of Levy. The Petitioner would respectfully reiterate its contention that the federal tax lien was postponed to the first and second priorities established in Section 64 of the Bankruptcy Act, 11 U.S.C. 104, as not being accompanied by actual possession of the taxpayer's personal property. Section 67c(3) of the Bankruptcy Act, 11 U.S.C. 107c(3).

The cornerstone of the argument of the United States seeking to avoid postponement is the case of *United States* v. *Eiland, supra.* The Fourth Circuit in *Eiland* held that the Internal Revenue Service properly asserted its lien through Notice of Levy upon an indebtedness owed to the taxpayer, thereby obtaining constructive possession of the chose in action and avoiding postponement of the federal tax lien to payment of expenses of administration and wage claims.

Eiland determined that the federal tax lien was not postponed for the reason that said section applies only to tangible personal property which can be taken into possession. No authority was cited in the opinion for this proposition, nor did the Court further elaborate on the basis of its conclusion that "personal property" was to be read as "tangible personal property". Justification of this result was attempted by the argument the service of Notice of Levy transferred the chose in action to the United States. However, as with *Eiland's* interpretation of Section 6323, its interpretation of Section 67c of the Bankruptcy Act, 11 U.S.C. 107c, likewise violates the purpose of that statutory provision. The Chandler Act introduced the postponement provisions when not accompanied by possession in order to subordinate statutory liens, including tax liens, to the first and second priorities of Section 64 of the Bankruptcy Act, 11 U.S.C. 104, in the same manner that unsecured claims were subordinated to these priorities. *Goggin* v. *Division of Labor Law Enforcement of California,* 336 U.S. 118, 69 S. Ct. 469, 93 L. Ed. 543 (1949). Congress found that statutory liens, and in particular tax liens, often consumed the entire estate, leaving expenses of administration and priority wage claims unpaid. *Ibid,* 336 U.S. 118, 127, 69 S. Ct. 469, 474, N. 8. The possibility

of this result caused concern on the part of Congress, which favored expenses of administration and priority wage claims over tax claims. H. Rept. 868 on H.R. 136, 89th Cong., 1st Sess. (1965). The House Judiciary Committee stated in its report that "(i)t would be grossly unfair for the bankruptcy court and the attorneys who have labored to wind up the bankrupt's affairs and to accumulate an estate for distribution to receive nothing for his labors". *Ibid,* at 7. The report also commented that "(i)t is also socially desirable that the claims of the wage earner who is normally entirely dependent upon his wages for the necessity of life should be paid to the extent of the restriction in Section 64a(2) before the estate is subject to the heavy burden of all tax liens". *Ibid.* The effect of the ruling of the Court of Appeals will be to deprive wage earners, not only of their limited priority, but of any recovery, contrary to the intent of Congress. If the wage earners are to be paid, their priority must be preserved by this Court. This is their only chance for recovery, whereas the United States has a priority status, and, in addition, maintains the right to assert the personal liability of the officials of the taxpayer, as provided in Section 6672 of the Internal Revenue Code of 1954, 26 U.S.C. 6672. This Court has also expressed its concern for preservation of these priorities and upheld their predominance over a claim for taxes under a trust theory advanced by the United States in *United States* v. *Randall, supra.*

Viewed against the legislative history of the postponement provision, the *Eiland* decision of the Fourth Circuit is an erroneous holding. However, this Court has considered Section 67c in *Goggin* v. *Division of Labor Law Enforcement of California, supra,* and has held

therein that *actual* possession is required to avoid postponement. 336 U.S. 118, 127, 69 S. Ct. 469, 474. Mere service of a Notice of Levy is inadequate to constitute actual possession of the assets in the United States. Notice alone will not give "a public warning of the existence of an enforceable statutory lien for taxes . . ." which is the purpose of Section 67c. *Goggin* v. *Division of Labor Law Enforcement of California*, 336 U.S. 118, 128, 69 S. Ct. 469, 475. See, *City of New York* v. *Hall*, 139 F.2d 935, 936 (2nd Cir. 1944). This conclusion is also supported by one of the leading commentators in the field. *Seligson*, Treatment of Statutory Liens in Bankruptcy — The 1966 Amendments of Section 67b and c, 27 Fed. Bar J. 111, 120-121 (Spring, 1967). The Petitioner urges this Honorable Court to follow its interpretation of Section 67c of the Bankruptcy Act as enunciated in *Goggin* and to reject the decision of the Fourth Circuit in *Eiland*, in order to effectuate the Congressionally determined purpose of protecting innocent third parties from secret tax liens.

In conclusion, the Petitioner submits that even if the Court holds that the United States enjoyed a valid lien, that lien was postponed in payment to the first and second priorities under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, for the reason that service of its Notice of Levy did not reduce the proceeds from the assignee's sale to the actual possession of the United States. Further action was required but was not taken. To hold otherwise would be to exalt fiction over carefully weighed policies. *In Re United General Wood Products Corp., supra.*

III.

THE EXERCISE OF SUMMARY JURISDICTION OF THE BANKRUPTCY COURT WAS PROPER FOR THE REASONS THAT THE BANKRUPTCY COURT OBTAINED CONSTRUCTIVE POSSESSION OF THE PROCEEDS ON THE DATE OF BANKRUPTCY OR, ALTERNATIVELY, ENJOYED SUMMARY JURISDICTION OVER THE ASSIGNEE FOR THE BENEFIT OF CREDITORS WHICH WAS NOT OUSTED BY THE INTERVENTION OF THE UNITED STATES.

The precedent established by the Court of Appeals for the Seventh Circuit in *In Re Chicagoland Ideel Cleaners, Inc., Bankrupt,* was that the Bankruptcy Court lacked jurisdiction, for the reason that the constructive possession of the proceeds of the assignee's sale had passed to the United States, depriving the Bankruptcy Court of possession, and, hence, of summary jurisdiction. As the Petitioner has sought to demonstrate heretofore, the United States did not enjoy a federal tax lien, or, alternatively, the lien was not accompanied by possession and was for that reason postponed in payment to expenses of administration and priority wage claims. If this Court supports either of the Petitioner's positions, summary jurisdiction existed in the Bankruptcy Court. Possession, whether actual or constructive, cannot be simultaneously held by two adverse claimants. In the event this Court holds that possession passed to the Bankruptcy Court as of the date of bankruptcy, then the decision of the Court of Appeals must be reversed and the order of December 9, 1971, of the Bankruptcy Court affirmed.

The Petitioner has previously urged and reiterates to this Court two bases of jurisdiction of the Bankruptcy Court independent of the question of possession of the bankrupt's property to the support that Court's summary

adjudication of the controversy confronting it. Section 2a(21) of the Bankruptcy Act, 11 U.S.C. 11a(21), provides that a representative such as an assignee for the benefit of creditors shall be subject to the jurisdiction of the Bankruptcy Court for the purpose of requiring that representative to turn over the property in his control and possession to the Receiver or Trustee in Bankruptcy. The procedure is summary in nature and designed to eliminate the delay and cost of a plenary proceeding as well as to provide a more effective control over the disbursements of the non-bankruptcy representative. *In Re John M. Russell, Inc.*, 318 U.S. 515, 63 S. Ct. 687, 87 L. Ed. 954 (1943). Similarly, Section 70a(8) of the Bankruptcy Act, 11 U.S.C. 110a(8), expressly provided for the exercise of summary jurisdiction over property held by an assignee for the benefit of creditors appointed under a general assignment.

The original proceedings before the Bankruptcy Court consisted of an application by your Petitioner for a turn over order against the assignee. (A. 9). Clearly, this was a summary proceeding. The assignee failed to answer the application but the United States did respond to it (A. 10). An answer by one not a party to a proceeding must be considered as an intervention into the existing proceeding. *Phelps* v. *Oaks*, 117 U.S. 236, 6 S. Ct. 714, 29 L. Ed. 888 (1886). Intervention cannot alter the nature of the pre-existing proceedings, *Vinson* v. *Washington Gas, Light Co.*, 321 U.S. 489, 64 S. Ct. 731, 88 L. Ed. 883 (1944), nor oust jurisdiction of the Court once properly invoked. *Mitchell* v. *Maurer*, 293 U.S. 237, 55 S. Ct. 162, 79 L. Ed. 338 (1934).

It would be anomalous, indeed, to allow the United States to intervene into a special and summary proceeding for the purpose of challenging the jurisdiction

of the Bankruptcy Court to hear and adjudicate the proceeding into which the United States intervened. The proper procedure that the United States ought to have followed would have been to diligently reduce the assets to its physical possession prior to the assignee's sale in which case it would have been entitled to a plenary proceeding, or to stand on its alleged rights outside of the bankruptcy proceeding, relying upon the possibility of a penalty under Section 6332(c) and a discharge under Section 6332(d) of the Internal Revenue Code of 1954, 26 U.S.C. 6332(c) and (d), to compel the assignee to deliver the proceeds to the Internal Revenue Service. In the latter instance, a plenary action would again be required. Failing to take either course, but following a period of somnolence in the assertion of its claimed rights with a course of action situated half way between the two permissible alternatives, it has created a jurisdictional confusion which clouds the vital issues erroneously adjudicated in this case by the Court of Appeals.

CONCLUSION

Based upon the foregoing, the Petitioner respectfully urges this Honorable Court to reverse the judgment of the United States Court of Appeals for the Seventh Circuit and to uphold the order of the Bankruptcy Court.

Respectfully submitted,

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APPENDIX

"Bankruptcy Act, 11 U.S.C. 1, et seq."

Section 2a. CREATION OF COURTS OF BANKRUPTCY AND THEIR JURISDICTION. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

(21) Require receivers or trustees appointed in proceedings not under this Act, assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person's property to deliver the property in their possession or under their control to the receiver or trustee appointed under this Act or, where an arrangement or plan under this Act has been confirmed and such property has not prior thereto been delivered to a receiver or trustee appointed under this Act, to deliver such property to the debtor or other person entitled to such property according to the provisions of the arrangement or plan, and in all such cases to account to the court for the disposition by them of the property of such bankrupt or debtor: *Provided, however,* That such delivery and accounting shall not be required except in proceedings under section 77 and chapters X and XII of this Act, if the receiver or trustee was appointed, the assignment was made, or the

agent was authorized more than four months prior to the date of bankruptcy. Upon such accounting, the court shall reexamine and determine the propriety and reasonableness of all disbursements made out of such property by such receiver, trustee, assignee, or agent, either to himself or to others, for services and expenses under such receivership, trusteeship, assignment, or agency, and shall, unless such disbursements have been approved, upon notice to creditors and other parties in interest, by a court of competent jurisdiction prior to the proceeding under this Act, surcharge such receiver, trustee, assignee, or agent the amount of any disbursement determined by the court to have been improper or excessive; and . . .

Section 64a. DEBTS WHICH HAVE PRIORITY. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of title 18 of the United States Code, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter

provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding, including expenses necessarily incurred by a debtor in possesion, receiver, or trustee in preparing the schedule and statement required to be filed by sections 238, 378, or 483, shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesmen" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the

bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18 of the United States Code, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: *Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority; *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; and (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by paragraph (2) of subdivision c of Section 67 of this Act: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

Section 67c(3). Every tax lien on personal property not accompanied by possession shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. Where such tax lien is prior in right to liens indefeasible in bankruptcy, the court shall order payment from the proceeds derived from

the sale of the personal property to which the tax lien attaches, less the actual cost of that sale, of an amount not in excess of the tax lien, to the debts specified in clauses (1) and (2) of subdivision a of Section 64 of this Act. If the amount realized from the sale exceeds the total of such debts, after allowing for prior indefeasible liens and the cost of the sale, the excess up to the amount of the difference between the total paid to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and the amount of the tax lien, is to be paid to the holder of the tax lien.

Section 70a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located ... (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this Act, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

"Internal Revenue Code of 1954, 26 U.S.C."

Section 6321. Lien for taxes

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether

real or personal, belonging to such person. Aug. 16, 1954, c. 736, 68 A Stat. 779.

Section 6322. Period of lien

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time. Aug. 16, 1954, c. 736, 68A Stat. 779; Nov. 2, 1966, Pub. L. 89-719, Title I, §113(a), 80 Stat. 1146.

Section 6323. Validity and priority against certain persons.

(a) Purchases[1], holders of security interests, mechanic's lienors, and judgment lien creditors. — The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate.

(f) Place for filing notice; form.—

(1) Place for filing.—The notice referred to in subsection (a) shall be filed—

(A) Under State laws.—

(i) Real property.—In the case of real property, in one office within the State (or the county, or other governmental subdivision), as designated by the laws of such State, in which the property subject to the lien is situated; and

(ii) Personal property.—In the case of personal property, whether tangible or intangible, in one office within the State (or the county, or other governmental

subdivision), as designated by the laws of such State, in which the property subject to the lien is situated; or

(B) With clerk of district court.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State has not by law designated one office which meets the requirements of subparagraph (A); or

(C) With Recorder of Deeds of the District of Columbia.—In the office of the Recorder of Deeds of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(2) Situs of property subject to lien.—For purposes of paragraph (1), property shall be deemed to tbe situated—

(A) Real property.—In the case of real property, at its physical location; or

(B) Personal property.—In the case of personal property, whether tangible or intangible, at the residence of the taxpayer at the time the notice of lien is filed.

For purposes of paragraph (2) (B), the residence of a corporation or partnership shall be deemed to be the place at which the principal executive office of the business is located, and the residence of a taxpayer whose residence is without the United States shall be deemed to be in the District of Columbia.

(3) Form.—The form and content of the notice referred to in subsection (a) shall be prescribed by the Secretary or his delegate. Such notice shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien.

Section 6331. Levy and distraint

(a) Authority of Secretary or delegate—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax.

Section 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully accounnt for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. Aug. 16, 1954, c. 736, 68 A Stat. 828.